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Muni Bond Market Heats Up As Fund Inflows Swell.

Summary

The municipal securities market continues to generate steam, as funds attract further inflows amid light new issuance.

US$1.72bn flowed into municipal bond funds and US$416m into ETFs, according to ICI, while municipal relative value ratios sunk to their lowest level in about a decade.

Holders of some major muni-fueled ETFs have also been enjoying a recent surge in value.

Meanwhile, the University of Pittsburgh Medical Center (UPMC) is set to offer around US$738m worth of revenue bonds through Pennsylvania's Allegheny County Hospital Development Authority.

Other deals on the radar for the week ahead include US$1.5m worth of general revenue bonds from New York's Triborough Bridge and Tunnel Authority, as well as almost US$486m of school district revenue bonds from the Dormitory Authority of the State of New York (DASNY).

The municipal securities market continues to generate steam, as funds attract further inflows amid light new issuance.

Flows into muni bond mutual funds and exchange-traded funds (ETFs) remained positive in the week ending May 1.

According to the Investment Company Institute (ICI), investors in the latest week added US$1.72bn to municipal bond funds and US$416m to ETFs, contributing to a tally of roughly US$35bn to date in 2019.

Holders of some major muni-fueled ETFs have also been enjoying a recent surge in value.

Prices of the iShares National Muni Bond fund (NYSEARCA: MUB) and the Vanguard Tax-Exempt Bond fund (NYSEARCA: VTEB), for example, have soared around 5% to 5.3% since their latest 52-week lows set in early November 2018 of US$106.575 and US$49.855, respectively, according to the IBKR Trader Workstation. MUB and VTEB were last up just north of 0.2% intraday Thursday, each setting new 52-week highs.

Janney Montgomery municipal strategist Alan Schankel recently highlighted that the muni bond market is "on one of the strongest performance streaks we've seen in a while, as light supply and continuing strong demand push relative value indicators, such as municipal-to-Treasury ratios, to cyclical lows." In fact, municipal relative value ratios have sunk to their lowest level in about a decade.

Schankel added that muni 'AAA' benchmark yields finished lower again Wednesday, despite a "poor" U.S. Treasury auction-fueled selloff.

Bloomberg data shows that 10-year state and local debt yields a little more than 72% of Treasuries, compared with just north of 73.5% in the previous session. They had yielded nearly 77.25% a month ago.

UPMC Graces the Fixed-Rate Calendar

Against this backdrop, a handful of issuers have potential new offerings on the fixed-rate calendar in the week ahead, including nearly US$738m worth of University of Pittsburgh Medical Center (UPMC) revenue bonds through Pennsylvania's Allegheny County Hospital Development Authority.

UPMC said it intends to apply the proceeds from the sale towards refunding certain existing outstanding indebtedness, as well as certain debt-related expenses.

The deal, which has serial maturities from July 15, 2020 through 2039, has been rated 'A1' by Moody's Investors Service, and 'A+' by both S&P and Fitch Ratings.

Fitch earlier in May had cut the revenue bond rating one notch to 'A+' from 'AA-' on UPMC's outstanding parity debt issued by UPMC and via other authorities, including the Pennsylvania Higher Educational Facilities Authority, Allegheny County Hospital Development Authority, and the Pennsylvania Economic Development Financing Authority.

Fitch analysts Olga Beck and Eva Thein noted that the credit rating downgrade was mainly due to UPMC's "lower liquidity position, which has historically lagged the 'AA' category and does not compare favorably to the system's higher leverage position."

At fiscal year-end 2018, UPMC's cash to adjusted debt fell to 90%, with investment losses incurred as of December 31, 2018.

Beck and Thein continued that while investment valuations have recovered in the first-quarter of fiscal 2019, the year-end results "highlight the vulnerability of a low cash position in times of market volatility for a system with a higher debt load and historically low cash flow generation."

Fitch added that while it expects UPMC's integrated delivery model, including its "aligned physician base, extensive health plan, and sizeable delivery network," to continue to "significantly shift the market in Western Pennsylvania in UPMC's favor," it also anticipates "no significant changes" in either its profitability or balance sheet metrics in the near to intermediate-term.

UPMC's debt service coverage ratio fell to 2.37x in the trailing twelve-month (TTM) period ended March 31, 2019 from 2.49x in the TTM ended December 31, 2018. Over the same period, its revenues available to service debt shrunk to US$930.5m from US$975.1m, while its debt rose to US$392.7m from US$391m.

Meanwhile, Moody's said its 'A1' reflects its expectations that UPMC will continue to benefit in large part from its "notable scale," with a consolidated revenue base of nearly US$19bn, as well as its leading market share in most of the markets it serves.

However, Moody's analyst Beth Wexler said she expects UPMC's financial profile to "remain stressed" over the intermediate-term. Furthermore, Moody's also attributed its negative outlook on the latest series 2019A deal to "modest" operating cash flow and balance sheet measures, which are likely to provide limited flexibility as UPMC's growth is digested.

In mid-August 2018, UPMC had also sold more than US$943m of tax-exempt muni bonds in four parts, with maturities ranging from 2023 to 2047. Its 10-year tranche had priced to yield 3.18%, a spread of nearly 73.5 basis points more than matched-maturity U.S. government debt.

Its proposed series 2019A debt is expected to be issued as fixed-rate, tax-exempt bonds and sold via negotiation the week of May 13, 2019.

In the meantime, other deals on the radar for the week ahead include US$1.5m worth of general revenue bonds from New York's Triborough Bridge and Tunnel Authority, as well as almost US$486m of school district revenue bonds from the Dormitory Authority of the State of New York (DASNY).

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